

# **Audit**



# **Report**

OFFICE OF THE INSPECTOR GENERAL

MANAGEMENT CONTROL ENVIRONMENT FOR THE  
DEPARTMENT OF DEFENSE EDUCATION ACTIVITY

Report No. 96-181

June 28, 1996

**Department of Defense**

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### **Acronyms**

CFO	Chief Financial Officers
DDESS	Domestic Dependent Elementary and Secondary Schools
DFAS	Defense Finance and Accounting Service
DoDDS	Department of Defense Dependents Schools
DoDEA	Department of Defense Education Activity
DSAMMS	Dependent Schools Automated Material Management System
FCS	Funds Control System
GAO	General Accounting Office
KAR	Key Accounting Requirement
MAIS	Major Automated Information System
WHS	Washington Headquarters Services



**INSPECTOR GENERAL  
DEPARTMENT OF DEFENSE  
400 ARMY NAVY DRIVE  
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June 28, 1996

**MEMORANDUM FOR ASSISTANT SECRETARY OF DEFENSE (FORCE  
MANAGEMENT POLICY)  
DIRECTOR, DEPARTMENT OF DEFENSE EDUCATION  
ACTIVITY**

**SUBJECT: Audit Report on the Management Control Environment for the Department  
of Defense Education Activity (Report No. 96-181)**

We are providing this audit report for review and comment. This is our third in a series of reports on the Department of Defense Education Activity. Management comments on a draft of this report were considered in preparing the final report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. Based on management comments, we added Recommendation A.5. to the Assistant Secretary of Defense (Force Management Policy). Also, the Department of Defense Education Activity comments were not fully responsive to the recommendations. Therefore, we request that the Assistant Secretary of Defense (Force Management Policy) and the Director, Department of Defense Education Activity, provide comments on the recommendations by August 28, 1996.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Robert J. Ryan, Audit Program Director, at (703) 604-9418 (DSN 664-9418) or Mr. Walter R. Loder, Audit Project Manager, at (703) 604-9413 (DSN 664-9413). See Appendix E for the report distribution. The audit team members are listed on the inside back cover.

*David K. Steensma*

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Deputy Assistant Inspector General  
for Auditing

# Office of the Inspector General, DoD

Report No. 96-181  
(Project No. 5LA-2027)

June 28, 1996

## Management Control Environment for the Department of Defense Education Activity

### Executive Summary

**Introduction.** The DoD Education Activity (DoDEA) consists of two primary components, the DoD Dependents Schools and the Domestic Dependent Elementary and Secondary Schools. In FY 1995, DoDEA received \$1.2 billion in appropriated funding. Public Law 103-356 requires DoD to provide consolidated financial statements for FY 1996 to the Office of Management and Budget. DoD consolidated financial statements will include the financial statements for DoDEA. The foundation of auditable and reliable financial information is a strong management control environment. This is our third in a series of reports on DoDEA related to our work in preparing for consolidated financial statements in DoD. The reports on the management of an Automated Information System by DoDEA and the potential Antideficiency Act violations are described in Appendix B.

**Audit Objectives.** The audit objective was to evaluate the overall financial management controls at DoDEA. Specifically, we evaluated the control environment including the organizational structure related to financial controls, the levels of responsibility for implementing internal controls, whether revenues and expenditures were properly recorded and accounted for to permit reliable preparation of financial reports and to maintain accountability over assets. We evaluated whether the financial system can produce reliable financial information needed to prepare financial statements required by the Chief Financial Officers Act. We also evaluated the management control program.

**Audit Results.** The DoDEA management control environment needed improvement. As a result, DoDEA did not have assurance that its internal policies and procedures were being implemented and achieved, that revenues and expenditures were properly recorded and reported, and that assets were properly managed (Finding A).

The DoDEA did not have a general ledger accounting system. As a result, it was unable to provide the information necessary to produce auditable and accurate financial statements required by the Chief Financial Officers Act (Finding B).

The DoDEA did not adequately implement its management control program and review accounting system controls as required. As a result, the DoDEA management control program could not be relied upon to verify the adequacy of controls for the assessable units and identify material weaknesses, and DoDEA incorrectly reported its accounting system was in compliance with GAO accounting requirements. (Finding C).

**Summary of Recommendations.** We recommend that DoDEA establish an independent internal review function or obtain the functions by contract or in partnership with another DoD component; improve controls over budget formulation, budget execution, accounting transactions, financial reporting, and assets; implement a general ledger accounting system; perform risk assessments and assign an associated

level of risk to all assessable units; evaluate the accounting system using all applicable key accounting requirements; and report the lack of a general ledger accounting system as a material weakness in its Annual Statement of Assurance. We also recommend that the Assistant Secretary of Defense (Force Management Policy) request assistance from the Under Secretary of Defense (Comptroller) and the Defense Finance and Accounting Service to help resolve DoDEA accounting, assets, and management control problems.

**Management Comments.** The DoDEA nonconcurred with establishing an independent internal review function. It stated that an internal review function could not fulfill its mission without increasing staffing and that it would accomplish the functions through its management control program. DoDEA nonconcurred with improving controls over budget formulation and budget execution, stating that there is no DoD regulation requiring budget submissions from subordinate activities and that it maintained strict budget execution controls before August of FY 1995 and after the start of FY 1996. DoDEA disagreed with the need to improve controls over accounting transactions and financial reporting and assets. It stated that controls were sufficient and that deficiencies had already been corrected or that improvements were being implemented. DoDEA nonconcurred with implementing a general ledger accounting system. It stated that its accounting system used the original Washington Headquarters accounting system design and controls and, therefore, approval of either the Defense Finance and Accounting Service or the Under Secretary of Defense (Comptroller) was not required. DoDEA also disagreed with the need to perform risk assessments and to use all applicable key accounting requirements when performing annual reviews. It stated that through its extensive use of alternative reviews, each assessable unit was reviewed every year. DoDEA stated its management control program exceeded regulatory requirements. See Part I for a complete discussion of management comments and Part II for the complete text of those comments.

**Audit Response.** Comments from the Director, DoDEA, did not adequately address the issues identified. The DoDEA management control environment continues to need improvement. DoDEA needs an internal review function and improved controls over budget formulation, budget execution, accounting transactions, financial reporting, and assets. Without a general ledger accounting system, DoDEA cannot provide information necessary to produce auditable and accurate financial statements. Based on management comments, we revised our recommendation on the internal review function to allow DoDEA to quickly obtain the benefits of a quality internal review function by alternative methods. We also added a recommendation to the Assistant Secretary of Defense (Force Management Policy) to request outside assistance to help DoDEA quickly start to resolve accounting and management control problems. We request that the Assistant Secretary of Defense (Force Management Policy) and DoDEA provide comments on the final report by August 28, 1996.

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## **Part I - Audit Results**

### Audit Background

The Department of Defense Education Activity (DoDEA) is a DoD field activity under the authority, direction, and control of the Assistant Secretary of Defense for Force Management Policy. DoDEA provides education to eligible DoD military and civilian dependents from pre-school through grade 12 at sites both outside and within the United States. Courses of study in DoDEA schools parallel those in public schools in the United States.

The DoDEA consists of two primary components, the Department of Defense Dependents Schools (DoDDS), and the Department of Defense Domestic Dependent Elementary and Secondary Schools (DDESS). DoDDS are located overseas and DDESS are located in the United States and its territories. DoDDS operations support is provided by a Europe and Pacific area service center. In FY 1994, DoDDS served approximately 90,000 students overseas in 191 schools and 1 community college. The DoDDS staff of approximately 12,500 was located in 14 countries. DoDDS ranks 22nd in size, when compared to United States school systems. Operations support for DDESS is provided by district offices. The DDESS staff of about 5,300 served approximately 32,000 students in 65 schools located throughout 7 states and the Commonwealth of Puerto Rico.

During FY 1995, the Director of DoDEA initiated a major reorganization. The purpose of the reorganization was to bring resources closer to the schools and increase accountability over program results. The reorganization included the establishment of area service centers in Europe and the Pacific and centralizing the responsibility for the internal management control program at DoDEA Headquarters. DoDEA has implemented a strategic plan to guide the organization into the next century.

The DoDEA has two sources of funding, Federal appropriations and tuition reimbursement. For FY 1995, DoDEA received \$1.2 billion in appropriated funding.

### Audit Objectives

The audit objective was to evaluate the overall financial management controls at DoDEA. Specifically, we evaluated the control environment including the organizational structure related to financial controls, the levels of responsibility for implementing internal controls, whether revenues and expenditures were properly recorded and accounted for to permit reliable preparation of financial reports and to maintain accountability over assets. We evaluated whether the financial system can produce reliable financial information needed to prepare financial statements required by the Chief Financial Officers (CFO) Act. We



also evaluated the management control program. See Appendix A for a discussion of the audit scope and methodology. See Appendix B for a summary of prior coverage related to the audit objectives.

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## **Finding A. DoDEA Management Control Environment**

The DoDEA management control environment needed improvement. Improvements were needed because DoDEA:

- o closed the independent internal review office without plans for replacement,
- o did not have adequate controls over budget formulation and execution,
- o did not have adequate controls for accounting transactions and financial reporting, and
- o did not have adequate controls over assets.

As a result, DoDEA did not have assurance that its internal policies and procedures were being implemented and achieved, that revenues and expenditures were properly recorded and reported, and that assets were properly managed.

## **Control Environment**

A control environment consists of the overall set of factors designed to achieve an organization's policies and procedures. According to accounting and auditing standards, elements of a control environment include:

- o an internal audit function,
- o the forecasting and budgeting system,
- o recording of revenues, expenditures, and financial reporting,
- o accountability over assets, and
- o documentation and communication supporting significant management decisions, plans, and policies.

## **Function of Internal Review**

The DoDEA closed its independent internal review office without plans for replacement. A strong management control environment includes an internal audit function. Before FY 1995, DoDEA had an independent internal review office in Germany that reported to the Director, DoDEA. In FY 1995, DoDEA believing the internal review office was not effective, closed the office and transferred the chief of that office to DoDEA Headquarters as the new internal control officer for the organization. DoDEA management stated that moving the internal control responsibility to DoDEA Headquarters would provide greater visibility of internal controls throughout the DoDEA organization.

Internal control responsibilities were placed under the associate director for accountability, a new position in DoDEA. The internal control officer, who does not have a staff, reports to the associate director. The internal control officer coordinates the internal management control program and tracks the status of reviews by external organizations. The internal control officer does not perform independent reviews.

**Need for an Internal Review Function.** An organizational element, such as an internal review office, performing independent internal audits is an important factor of a control environment. To maintain independence, the internal review function should be aligned and report to the director of the organization. An independent internal review function properly aligned in the organization, staffed, trained, and utilized would provide DoDEA a greater assurance that internal policies and procedures are being implemented and achieved. In addition, the internal review function through audits and other reviews would help ensure that organizational functions are operating efficiently, and that identified weaknesses are being corrected. If DoDEA does not want to establish its own internal review function, it needs to identify an acceptable alternative, such as contracting for audit services or requesting support from another component in DoD. The requirement to prepare financial statements contains additional requirements that DoDEA has not begun to perform, such as testing audit trails for financial transactions, inventory account balances, and other financial account balances.

The General Accounting Office (GAO) supports the need for an internal audit function in "Standards for Internal Controls in the Federal Government," 1983. The GAO Standards state, "One important way for management to demonstrate its support for good internal controls is its emphasis on the value of internal auditing and its responsiveness to information developed through internal audits."

**Staffing.** A strong management control environment includes an internal review function with staffing that correlates to the overall mission, size of the organization, number of locations, and assessment of the financial and other risks. DoDEA with approximately \$1.2 billion in appropriated funds, consists of DoDEA Headquarters in Arlington, Virginia, and 256 schools in 15 countries and the Commonwealth of Puerto Rico.

## **Finding A. DoDEA Management Control Environment**

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Similar sized DoD organizations have an internal review function with staffing of about 30 people. For example, the Defense Commissary Agency has an inspector general office and an internal review function with a staff of approximately 33 people. In FY 1995, the Defense Commissary Agency had about 19,000 authorized personnel and received approximately \$940 million in appropriated funds to support the operation of about 300 commissary stores located in the United States and overseas.

### **Budget Formulation and Execution**

The DoDEA did not have adequate controls over budget formulation and execution. Controls were not adequate because DoDEA management:

- o eliminated the requirement for managers from subordinate organizations, such as DoDEA divisions and area service centers, to assist in the budget formulation process, and did not use budget submissions to formulate its FY 1995 budget, and

- o eliminated budget execution controls over program codes and disregarded controls for equipment purchases.

**Budget Submissions from Subordinate Organizations.** The DoDEA management eliminated the requirement for managers from subordinate organizations to submit budgets for use in the budget formulation process. Before December 1994, DoDEA Regulation 7100.2, "DoD Dependents Schools Budget Execution," July 18, 1989, required each manager to assist in budget formulation and resource allocation, by recommending the best mix of resources. In December 1994, the Directive was revised and that requirement was eliminated.

In the FY 1995 budget formulation process, DoDEA did not use budget submissions from subordinate organizations. DoDEA used the prior year's spending, adjusted through a formula process, to formulate its FY 1995 budget. We reviewed the DoDEA submission for the FY 1995 President's Budget and could not determine a direct relationship to those budget submissions provided by subordinate organizations. As a result of not including budget input from subordinate organizations in the budget formulation process, DoDEA management could not ensure that its budget submission was its best estimate of need.

## Finding A. DoDEA Management Control Environment

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**Budget Execution Controls Over Program Codes.** The DoDEA eliminated budget execution controls over program codes. Program codes are budgetary controls that allow management to monitor budget formulation and execution by specific cost centers. They denote educational programs and other services that DoDEA provides to its students and employees.

On August 11, 1995, DoDEA issued a memorandum that stated, "Effective immediately, controls on funding are eliminated between program codes within each organization code." Before that memorandum was issued, a special project budget request form was required to transfer or reprogram funds between program codes. The August 11, 1995, memorandum, allowed DoDEA managers to use authorized funding for specific program codes for other than the intended purpose.

By eliminating budget execution controls over program codes, DoDEA used \$9.6 million in funds for other than the intended purpose. In FY 1995, the budget for the headquarters (non-labor cost) program code submitted by the Management Information System division was approved at \$0.7 million. In the last quarter of FY 1995, DoDEA reprogrammed funds and authorized a total of \$10.3 million for the program code, using \$9.6 million in funds for other than the intended purpose.

**Budget Execution Controls for Equipment Purchases.** The DoDEA disregarded budget execution controls, such as plans showing monthly spending by object class, for equipment purchases. By disregarding established controls, DoDEA may have violated the "bona fide" need rule as set forth in United States Code, title 31, section 1502(a). The bona fide need rule requires that obligations against a fiscal year appropriation be used to meet a legitimate, or bona fide, need of the fiscal year for which the appropriation was made. Items purchased during the year must be supported by a requirement for that fiscal year.

The DoDEA did not establish monthly spending plans for equipment purchases. Additionally, DoDEA did not have requirements documentation supporting a bona fide need for equipment purchased in the last month of FY 1995. DoDEA used Operations and Maintenance funds for equipment purchases. In the last month of FY 1995, obligations for equipment were significantly higher than in the first 11 months. The FY 1995 DoDEA equipment purchases totaled about \$27.9 million, \$24.1 million (86 percent) of the purchases occurred in the last month of FY 1995. DoDEA Headquarters, purchased 98.5 percent of its equipment in the last month of FY 1995. DoDEA did not have requirements documentation supporting the \$24.1 million in purchases.

## **Controls over Accounting Transactions and Financial Reporting**

The DoDEA did not have adequate controls over accounting transactions and financial reporting because it:

- o did not have a financial system that collected and consolidated accounting transactions for all organizational units,
- o did not have adequate accounting policies and procedures, and
- o had not developed adequate procedures for the review of financial reports to ensure accuracy and completeness and to identify material irregularities.

As a result, there was no assurance that accounting transactions were recorded properly and financial reports were complete and accurate.

**Collecting and Consolidating Accounting Transactions.** The DoDEA did not have a financial system that collected and consolidated accounting transactions for all organizational units. DoDEA used a system called the Funds Control System (FCS) to separately process accounting transactions at DoDEA Headquarters and at the DoDDS Europe and Pacific area service centers. DDESS processed accounting transactions through the Defense Finance and Accounting Service (DFAS)-Pensacola and DFAS-Cleveland. The FCS located at DoDEA Headquarters, did not have the capability to collect or consolidate accounting transactions from DoDEA Headquarters, the DoDDS Europe and Pacific area service centers, and DDESS. Therefore, to prepare financial reports, such as the Report on Budget Execution, Flash Report on Obligation Status, and Appropriation Status by Fiscal Year Program, DoDEA personnel had to manually consolidate accounting data from up to 410 source reports.

The manual preparation of financial reports was a management control weakness. Manual data input, and report preparation errors were more likely when not using an automated system. Manual preparation was time consuming, and therefore not an efficient use of resources. Also, less time was available to review the integrity of the information in the financial reports. As a result, DoDEA could not provide adequate assurance that financial reports were reliable; and the accounting data in the reports could not be easily traced to the supporting documentation.

**Accounting Policies and Procedures.** The DoDEA did not have adequate accounting policies and procedures. Its accounting manual did not include accounting transactions processed through DDESS. The DoDEA accounting manual, Dependents Schools Manual 7200.9, "DoDDS Accounting Manual," October 1990, also did not clearly implement requirements set forth in the DoD Financial Management Regulation 7000.14R (the Financial Regulation) for recording accruals. In addition, DoDEA Headquarters accounting guidance for recording disbursements for special projects did not comply with the Financial Regulation.

## Finding A. DoDEA Management Control Environment

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**DoDEA Accounting Manual.** The DoDEA accounting manual applied to DoDDS and not DDESS. DDESS was established as part of DoDEA in FY 1994 and became part of the DoDEA fiscal division in FY 1995. The Director, DoDEA, informed us that management was in the process of fully incorporating DDESS into the DoDEA organization. However, the absence of accounting policies and procedures for DDESS led to inaccurate disbursement amounts in DoDEA financial reports. For example, DFAS-Cleveland reported the DDESS disbursement amounts from Treasury disbursing records, and not from the supporting accounting records located at DFAS-Pensacola. DoDEA used disbursement amounts reported by DFAS-Cleveland. If the DoDEA accounting manual applied to DDESS, DoDEA personnel would know to use disbursement amounts supported by accounting transactions from DFAS-Pensacola as opposed to amounts from Treasury disbursing records.

**Policies and Procedures for Recording Accruals.** The DoDEA had not developed adequate policies and procedures to record accruals for accounts payable upon the receipt of goods and services as required by the Financial Regulation. To record accruals, the DoDEA manual states, "accruals must be recorded in the allotment accounting system upon receipt of goods or services." It further states, "accruals may be recorded simultaneously with either an obligation or a disbursement in order to minimize workload provided that accounts payable are not overstated in cases where an accrual indicates a receipt of goods or services."

The Financial Regulation states, "Until goods and services are received by a DoD Component, the transaction is recorded in the budgetary accounts as an undelivered order" (that is, at time of obligation). "When an accounting station receives evidence that performance has occurred, the transaction is recorded simultaneously in the budgetary accounts as an accrued expenditure unpaid and in the proprietary accounts as an accounts payable." The DoDEA accounting manual did not clearly implement the Financial Regulation.

The options in the DoDEA accounting manual led to DoDEA Headquarters and the DoDDS area service centers recording the accruals for accounts payable differently and not according to the Financial Regulation. For instance, DoDEA Headquarters did not record accounts payable for goods and services except payroll. In contrast, the DoDDS Europe area service center recorded undelivered orders as accounts payable. As a result, accounts payable for DoDDS Europe included in the DoDDS September 1995, Report on Budget Execution could be misstated as much as \$126 million.

**Accounting Guidance for Disbursements.** DoDEA Headquarters issued accounting guidance for recording disbursements for special projects that did not comply with the Financial Regulation. The accounting guidance states that transactions by others (disbursements) for special projects at DoDEA Headquarters should not be posted to the allotment accounting system if funding was insufficient or nonexistent. Thus, services were incurred but no transaction would be recorded if sufficient funds were not available. The Financial Regulation states, "once incurred, all obligations and expenditures shall be recorded, accurately and promptly, as of the date incurred even if recordation results in a negative amount in the accounting records for an appropriation or

## **Finding A. DoDEA Management Control Environment**

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fund or an administrative subdivision of an appropriation." The accounting guidance from DoDEA Headquarters for recording special project disbursements did not comply with the Financial Regulation and significantly increased the risk of inaccurate financial records.

**Procedures for the Review of Financial Reports.** The DoDEA had not developed adequate procedures for the review of financial reports to ensure accuracy and completeness and to identify material irregularities. Although we did not review all DoDEA financial reports, we identified foreign currency fluctuations reports that were not complete, a report on unmatched disbursements that was not accurate and complete, and reports on budget execution, hereafter called the 1176 Report, that were not accurate and that had material irregularities.

**Foreign Currency Fluctuation Reports.** Reviews of foreign currency fluctuation reports did not ensure that the reports were complete for Military Construction funds. The DoDEA submitted monthly foreign currency fluctuation reports for both Operations and Maintenance and Military Construction funds to DFAS-Indianapolis where they were consolidated and submitted to the Under Secretary of Defense (Comptroller). The reports from FY 1994 and FY 1995 for the Operations and Maintenance fund appeared complete. However, the Military Construction reports lacked required information, such as liquidated and unliquidated obligations, accrued and anticipated realized variances, and projected 6-month disbursements. DoDEA personnel indicated that the reports had always been prepared without the above information. Nevertheless, without complete foreign currency fluctuation data, the Under Secretary of Defense (Comptroller) could not adequately plan future year funding for DoDEA military construction.

**Report on Unmatched Disbursements.** The Chief of the DoDEA fiscal division did not adequately review the September 1995 Report on Unmatched Disbursements, to ensure that the report was accurate and complete. DFAS required DoDEA to submit a monthly report on the amount of unmatched disbursements. In September 1995, DoDEA reported \$5.6 million in unmatched disbursements. However, the amount did not include \$45 million that the DoDDS Europe area service center reported. According to DoDEA Headquarters, the \$45 million of unmatched disbursements was not included because the Europe area service center could not provide DoDEA Headquarters with the number of transactions that were unmatched. The unmatched disbursement report did not mention the \$45 million omission.

**The 1176 Report.** The DoDEA did not perform adequate reviews of the 1176 Report, therefore, did not recognize that it was inaccurate. The 1176 Report summarized the status of the DoDEA appropriations. DoDEA included noncurrent DDESS information in the manually consolidated 1176 Report; and with the exception of yearend reporting, it also used month old DDESS information in the 1176 Report. For example, in the DoDEA consolidated August 1995 1176 Report, DoDEA used July 1995 data for DDESS. However, at the end of FY 1995, DoDEA used DDESS data from September 1995. The DDESS data from August 1995 was never used and DoDEA did not identify the omission.



## **Finding A. DoDEA Management Control Environment**

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The 1176 Report for a DoDEA appropriation also changed from being overobligated for 1993 and 1994 to having a positive balance in September 1995. A difference of approximately \$1 million was reported for the appropriation in August 1995 and September 1995. The August 1995 1176 Report showed an overobligated balance of \$0.9 million. In September 1995, the amount changed to an available balance of \$0.2 million. DoDEA did not review and identify the material irregularity, although the appropriation showed an overobligated balance for the past 2 years as having been liquidated in September 1995. Inspector General, DoD, Report No. 96-159, "Quick-Reaction Report on Potential Antideficiency Act Violations at the Department of Defense Education Activity," June 13, 1996, identified two potential antideficiency violations related to the 1176 Reports and recommended initiation of an investigation.

### **Controls Over Assets**

The DoDEA did not have adequate controls over assets because:

- o the Dependent Schools Automated Material Management System (DSAMMS) Users Manual needed improvement by including procedures to ensure that information included in the DSAMMS property records were accurate, promptly recorded, consistent, and complete,
- o the reasons for asset losses were not explained,
- o the DSAMMS property records were not reconciled to the financial system to verify accuracy, and
- o asset accountability had not yet been established for the DDESS.

As a result, DoDEA could not use the information in the DSAMMS property records to support acquisition decisions. The DoDEA financial system did not accurately reflect information in the DSAMMS property records. In addition, DoDEA did not have accountability for assets in all DoDEA organizational units.

**DSAMMS.** DoDEA fielded DSAMMS in FY 1990 to improve property accountability. In FYs 1994 and 1995, DoDEA completed and deployed system upgrades that allowed the system to be used for inventory purposes.

**Policies and Procedures.** The DSAMMS Users Manual needed improvement by including procedures to ensure that information included in the DSAMMS property records were accurate, promptly recorded, consistent, and complete. For example, there was no procedure requiring the validation of asset cost with supporting documentation to ensure accuracy of cost information in the DSAMMS property record. In addition, the Users Manual did not provide consistent asset descriptions for the assets included in the property record. As a

## **Finding A. DoDEA Management Control Environment**

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result, we identified information in the DSAMMS property record that was inaccurate, not promptly recorded, inconsistent, and incomplete.

For example, two DoDEA assets, valued at \$144,500, were not recorded in DSAMMS. Another asset valued at less than \$100 was recorded as having an acquisition cost of \$92,000, while other assets in the property record had been disposed of 12 months ago. Further, asset descriptions for computer equipment ranged from providing the manufacturer and model, to simply "CPU". In addition, data fields, providing information such as acquisition date and asset location often were not complete.

**Reasons for Asset Losses.** The DoDEA did not determine the specific reasons for asset losses. Specific reasons are needed to promptly detect and correct errors; evaluate controls over assets; and prevent fraud, waste, and abuse. In FY 1995, DoDEA personnel performed asset inventories at DoDDS schools. However, the usefulness of inventory results was limited because losses were often not explained. In FY 1995, DoDDS Europe reported asset losses in excess of \$4.3 million through the reports of survey. The reports of survey explained the cause for over 84 percent of the losses as "other", therefore, the specific cause was not identified.

**Reconciliations of Property and Financial Systems.** The DoDEA did not reconcile the DSAMMS property records to the financial system. This condition has been reported since 1985. An Inspector General, DoD, Inspection Report No. 91-INS-03 "Department of Defense Dependents Schools," March 1, 1991, a followup to Inspector General, DoD, "Inspection of the Department of Defense Dependents Schools," January 8, 1985, reported that DoDEA did not perform reconciliations between the property records and the financial accounting system. DoDEA identified the weakness in its Annual Statements of Assurance. However, according to the DoDEA FY 1995 Annual Statement of Assurance, DoDEA did not plan to correct the deficiency until 1997. A detailed plan with milestones was not available. Although, DoDEA intends to develop an automated solution to interface the property records with the financial system, DoDEA did not develop an implementation plan with milestones and interim manual or supplemental policy and procedures to correct the problem.

**Asset Accountability for DDESS.** The DoDEA had not assumed asset accountability for DDESS, a major unit in the DoDEA organization. DoDEA had not developed policies and procedures to establish controls for DDESS assets, including maintaining the property records and preparing reports of survey. Additionally, personnel at DoDEA Headquarters did not know the amount, value, or makeup of DDESS assets.

## **Summary**

A control environment consists of the overall set of factors designed to achieve an organization's policies and procedures. The DoDEA control environment

## **Finding A. DoDEA Management Control Environment**

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needed improvement because DoDEA did not have an internal review function or acceptable alternative. In addition, controls were not adequate over budget formulation and execution, recording accounting transactions and financial reporting, and assets. As a result, DoDEA did not have assurance that its internal policies and procedures were being implemented and achieved, that revenues and expenditures were properly recorded and reported, and that assets were properly managed.

### **Recommendations, Management Comments, and Audit Response**

#### **A. We recommend that the Director, Department of Defense Education Activity:**

**1. Establish an independent internal review function, properly aligned in the organization, that is staffed, trained, and utilized to provide coverage for the entire organization or provide an acceptable alternative by contracting or partnership arrangement with another DoD component.**

**Management Comments.** The DoDEA nonconcurred and stated that the closed internal review office could not fulfill its mission without increasing personnel staffing and funding. DoDEA uses the Office of Management and Budget Circular No. A-123, "Management Accountability and Control," June 2, 1995, as the criteria for incorporating the functions of the internal review office in its management control program. DoDEA plans to obtain audit, investigative, and inspection services from the cognizant DoD audit organization and the Services and by contract from external sources.

**Audit Response.** We consider the DoDEA comments contradictory to comments from the Deputy Assistant Secretary of Defense (Personnel Support, Families, and Education) provided in a briefing with our office. The Deputy Assistant Secretary of Defense stated that she directed DoDEA to establish an internal review function and she provided the additional resources to the DoDEA budget. External reviews and the functions of an internal review office complement the management control program. Independent and objective reviews cannot be accomplished through a management control program. We concluded after making an assessment of the overall mission; size of the organization; number of locations; and financial and other risks, that an internal review function is required for DoDEA to maintain an adequate management control environment. The problems identified in reports 96-125, 96-159, and our ongoing review of property may not have occurred or at least would have been identified sooner with an adequate internal audit function. The DoDEA has to find the resources for it to accomplish the requirements of producing financial statements. This would include testing its property inventory, preparing and testing audit trails for accounts receivables and payables, and reconciling balances from subsidiary accounts to financial statements. Recognizing that DoDEA will require time and resources to establish a quality internal review function, we modified the recommendation to allow DoDEA to

## **Finding A. DoDEA Management Control Environment**

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obtain internal audit assistance through alternative methods. We request that DoDEA reconsider its position and provide additional comments on the final report.

### **2. Develop and implement guidance to control budget formulation and execution. Specifically,**

#### **a. Require budget submissions from subordinate organizations and use them in budget formulation.**

**Management Comments.** The DoDEA nonconcurred with the recommendation, stating that no DoD regulation requires formulation of the budget based on budget submissions from subordinate organizations. DoDEA stated that it conforms to a common practice in U.S. public school districts of formulating budgets at the central office and distributing funding by formula.

**Audit Response.** While we agree that there is no DoD regulation specifically requiring formulation of the budget based on budget submissions from subordinate organizations, DoD policy does require that an organization's budget be supported by documented requirements. DoDEA did not have that supporting documentation. The DoDEA submission for the FY 1995 President's Budget did not reflect the requirements submitted from subordinate organizations. Preparing a budget by formula disregards the bona fide needs of subordinate organizations. Without adequate input from subordinate organizations, the budget may be more or less than bona fide requirements and increases the risk of not having adequate support for the budget. We request that DoDEA reconsider its position and provide additional comments on the final report.

#### **b. Establish and maintain budget execution controls for spending within program codes and in compliance with the bona fide need rule.**

**Management Comments.** The DoDEA nonconcurred with the recommendation, stating that the budget execution controls for spending within program codes were eliminated only for August and September of FY 1995 to reduce the work load required in shifting budget targets at yearend. Before August of FY 1995 and after the start of FY 1996, strict controls were in place. In addition, DoDEA stated that because many costs were not known until late in the fiscal year, DoDEA must ensure that all bills can be paid before embarking on equipment purchases.

**Audit Response.** The DoDEA management control environment needed improvement because controls over budget execution were not evenly applied throughout the fiscal year. Proper budget formulation and other budget execution controls would accommodate expected increases in cost variables and ensure more even spending for equipment purchases. We request that DoDEA reconsider its position and provide additional comments on the final report.

## Finding A. DoDEA Management Control Environment

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**3. Establish and maintain controls over accounting transactions and financial reporting. Specifically,**

**a. Develop a financial system that collects and consolidates all accounting transactions for the DoD Education Activity Headquarters, DoD Domestic Dependent Elementary and Secondary Schools, and the DoD Dependents Schools Europe and Pacific area service centers.**

**Management Comments.** The DoDEA concurred with the recommendation, stating that DFAS had already begun an initiative that will consolidate all accounting transactions into a central data base for all Treasury Index 97 allotment holders and prepare departmental reports for Defense agencies.

**Audit Response.** Although DoDEA concurred, the comments do not address the need for a single consolidated financial accounting system that will collect and consolidate accounting transactions for all organizational units. We request that DoDEA provide additional comments on the recommendation.

**b. Revise its accounting manual to conform with DoD Financial Management Regulation 7000.14R. The manual should include policies and procedures on accounting transactions processed through DoD Domestic Dependent Elementary and Secondary Schools and on recording accruals for accounts payable upon receipt of goods and services. The manual should also revise accounting guidance for recording special project disbursements to conform with DoD Financial Management Regulation 7000.14R.**

**Management Comments.** The DoDEA nonconcurred with the recommendation, stating that because DDESS accounting is provided by DFAS, policies and procedures should not be included in a manual that supports a non-DFAS system.

In addition, DoDEA partially concurred with revising policies and procedures for recording accruals upon receipt of goods and services. It agreed to issue a procedural memorandum establishing a threshold for when accruals may be recorded simultaneously with either an obligation or a disbursement to minimize work load.

Further, DoDEA nonconcurred with revising its accounting guidance for recording special project disbursements. It stated that it was a desk procedure intended to reduce erroneous postings and not to circumvent the law. DoDEA stated that to avoid confusion, it had rescinded the paragraph from the desk procedures.

**Audit Response.** Although DFAS processes accounting transactions for DDESS, that information is transmitted to DoDEA for the purposes of financial reporting. DoDEA accounting policies and procedures did not discuss how DDESS information should be processed and the required supporting documentation. Although the DoDEA accounting manual applied only to DoDDS, the Director, DoDEA, stated that management was in the process of fully incorporating DDESS in the DoDEA organization. Revising accounting

## **Finding A. DoDEA Management Control Environment**

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policies and procedures to include DDESS is necessary to accomplish this goal. The Financial Regulation does not give an option allowing accruals to be recorded simultaneously with either an obligation or a disbursement to minimize the work load given a monetary threshold. The DoDEA satisfied the intent of the recommendation to post all disbursements when they occur, by rescinding the accounting guidance. We request that DoDEA provide additional comments on the recommendation.

**c. Establish procedures for the review of financial reports to ensure their accuracy and completeness and to identify material irregularities.**

**Management Comments.** The DoDEA concurred with the recommendation, stating that the deficiency was corrected in October 1995. However, DoDEA nonconcurred that reviews of foreign currency fluctuation reports did not ensure that the reports were complete for MILCON funds. Agreeing that the reports were not complete, DoDEA stated that there is no effective way of predicting foreign currency values.

The DoDEA concurred that its review of the September 1995 Report on Unmatched Disbursements did not ensure that the report was accurate and complete. DoDEA stated that because DFAS recently established the reporting requirement, and because of the large volume of transactions in DoDDS Europe, it had difficulty providing the required breakout of data. DoDEA accurately reported unmatched disbursements in October 1995 and in all subsequent reports.

Further, DoDEA stated that it did not perform adequate reviews of the Report on Budget Execution, and, therefore, did not recognize that the report was inaccurate. It stated that DDESS information is not received in time to prepare the monthly reports resulting in August data for DDESS being skipped every year. DoDEA also stated that it was aware of the change in obligation status for a DoDEA appropriation, but did not believe the report was inaccurate or that there was a material irregularity. However, DoDEA stated that it will footnote the report in the future if similar circumstances occur.

**Audit Response.** DoDEA agreed that the foreign currency fluctuation reports were not complete, but did not provide corrective actions. In addition, although DoDEA agreed that its review of the September 1995 Report on Unmatched Disbursements did not ensure that the report was accurate and complete, it did not provide the procedures implemented to ensure that reviews would detect such omissions in the future, and the date the procedures would be put in place.

Further, DoDEA had not taken corrective action to establish procedures for the reviews of the Report on Budget Execution to ensure that the reports are accurate and complete. In addition, its response on the change in obligation status contradicts its comments on Inspector General, DoD, Report No. 96-159, "Quick-Reaction Report on Potential Antideficiency Act Violations at DoDEA," June 13, 1996. In those comments, DoDEA agreed that balances in the Report on Budget Execution for September 1995 were inaccurate and that adjustments

## Finding A. DoDEA Management Control Environment

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to the incorrect accounts would be made. We request that DoDEA reconsider its position and provide additional comments on the final report.

### **4. Establish controls over assets. Specifically,**

**a. Develop policies and procedures to ensure that information in the Dependent Schools Automated Material Management System is accurate, promptly recorded, consistent, and complete.**

**Management Comments.** The DoDEA partially concurred with the recommendation, stating that policies and procedures are in place requiring accurate, promptly recorded, consistent, and complete entries into the property record. DoDEA plans to establish a single, standard catalog to assist property custodians in providing the correct nomenclature for property assets. In addition, DoDEA stated that all fields in the property record should not be mandatory because many have been included as a users option and are not required by DoD asset accountability regulations or directives. DoDEA did not concur that the DSAMMS Users' Manual needed improvement, stating that the DSM 4100.2 "DoDDS Material Management Manual," provided the property accounting procedures.

**Audit Response.** The DoDEA property accountability controls did not ensure the property records were complete and accurate. Controls are needed to ensure that all assets are accurately and promptly recorded in the DoDEA property record. It is not our intent to require the procedures to be included in the DSAMMS Users' Manual. We consider the development of a standard catalog of property descriptions responsive to the recommendation. However, we request that DoDEA provide additional comments on this recommendation.

**b. Identify and independently verify the reasons for asset losses included in the reports of survey.**

**Management Comments.** DoDEA partially concurred, stating that policies and procedures are in place for conducting investigations of property losses, and when further investigation is required a Financial Liability Officer will be appointed. In addition, DoDEA stated that when the term "other" is used to identify the cause of an asset loss, it is because the loss was discovered during the inventory process and there is no record of the item's actual disposition.

**Audit Response.** We do not consider the DoDEA comments responsive to the recommendation because the existing controls do not require specific reasons for asset losses. In FY 1995, DoDDS Europe reported asset losses in excess of \$4.3 million through Reports of Survey. It is not acceptable to have asset losses of that magnitude and have no idea 85 percent of the time of the item's actual disposition. We request that DoDEA reconsider its position and provide additional comments on the recommendation.

**c. Develop an implementation plan with milestones and interim manual procedures to reconcile the Dependent Schools Automated Material Management System to the financial system.**

## **Finding A. DoDEA Management Control Environment**

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**Management Comments.** The DoDEA concurred, stating that the effort will be undertaken as a joint logistics and fiscal responsibility.

**Audit Response.** We ask that DoDEA provide an implementation plan and a date by which the actions will be completed in response to the final report.

**d. Develop policies and procedures, to include maintaining the property records and preparing the reports of survey, for the DoD Domestic Dependent Elementary and Secondary Schools.**

**Management Comments.** The DoDEA concurred, stating that initial planning has been started to field the DSAMMS Property Accountability module within DDESS.

**Audit Response.** We request that DoDEA provide the completion date for its planned action in its response to the final report.

**5. We recommend that the Assistant Secretary of Defense (Force Management Policy) request assistance from the Under Secretary of Defense (Comptroller) and Director, Defense Finance and Accounting Service, to help DoDEA improve its accounting, budgeting, property management, and management control program.**

**Added Recommendation.** Based on comments from DoDEA to this report, Report No. 96-125, Report No. 96-159, and our ongoing work, we recognized that DoDEA has not initiated aggressive action to start resolving management problems unrelated to its training mission. Because DoDEA is one of the smaller components in DoD, we believe it would be more efficient for DoDEA to obtain assistance from other DoD activities that have already resolved or are resolving problems similar to those identified in this report.



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## **Finding B. General Ledger Accounting System**

The DoDEA did not have a general ledger accounting system. A system did not exist because DoDEA did not adequately plan for the development of a general ledger accounting system and place a high priority on correcting previously identified accounting system deficiencies. As a result, DoDEA was unable to provide the information necessary to produce auditable and accurate financial statements required by the CFO Act.

### **Requirements for a General Ledger Accounting System**

The Financial Regulation establishes requirements for a general ledger accounting system. A general ledger accounting system uses a double entry method whereby every debit entry has a corresponding credit entry. Audit trails to the original documents and transactions must be established and maintained. The Financial Regulation also requires the use of the DoD Uniform Chart of Accounts in DoD accounting systems.

The DoD Uniform Chart of Accounts is intended to ensure the consistent treatment of similar transactions. The Financial Regulation states that the account structure shall be used to record all of the series of events that occur from the time an appropriation is received until the resources acquired are used or disposed. A self-balancing set of budgetary accounts covers the appropriation, apportionment, allocation, commitment, obligation, and expenditure process. Proprietary asset and liability accounts cover the receipt of funds in the Treasury, the proper classification of assets (such as fixed assets, inventory, and receivables), and the recognition and proper classification of liabilities. Revenue and expense accounts measure the realization of revenues from the sale of goods and services, and the recognition of costs through the use and consumption of assets. The financial control provided through accounting records for property provides managers with a tool that will help to discharge effectively their stewardship function for those resources.

A conforming general ledger accounting system is necessary to provide information for auditable and accurate financial statements. In accordance with Public Law 103-356, The Federal Financial Management Act of 1994, and the CFO Act of 1990, DoDEA is required to prepare auditable and accurate financial statements for FY 1996, and each succeeding year. DoDEA financial statements will be consolidated with those of other organizations into financial statements for all of DoD. Appendix C details the actions needed for DoDEA to produce information necessary for reliable and auditable financial statements.

## **Finding B. General Ledger Accounting System**

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### **DoDEA Accounting System**

The DoDEA did not have a general ledger accounting system. DoDEA used the FCS, a budget-based system to organize funding and provide accountability for appropriated funds. The FCS is not a double entry, transaction-based system. Audit trails for all transactions are not maintained. In addition, the FCS does not use the DoD Uniform Chart of Accounts to include proprietary and asset accounts. The FCS can not provide the accounting information necessary to prepare consolidated DoD financial statements.

### **Planning for a General Ledger Accounting System**

The DoDEA did not adequately plan for the development of a general ledger accounting system. DoDEA should have coordinated accounting system development efforts with DFAS and the Under Secretary of Defense (Comptroller). The FCS was developed without general ledger functions and plans to develop an integrated accounting system have failed. As a result, the DoDEA accounting system was unable to provide the information necessary to produce auditable and accurate financial statements required by the CFO Act.

**Coordination of Financial Accounting System With DFAS and Under Secretary of Defense (Comptroller).** As part of the planning process, DoDEA did not coordinate accounting system development efforts with DFAS and the Under Secretary of Defense (Comptroller). In a response to an April 1994 House Armed Services Committee report, stating that the DoDEA accounting system is inadequate, both DoD and DFAS indicated they were not familiar with the DoDEA plan to develop an independent accounting system. In addition, DFAS believed DoDEA was using the WHS accounting system. DoDEA had not used the WHS system, in its entirety, since 1987.

**System Used Before the Funds Control System.** In 1987, DoDEA adopted accounting and finance modules from the WHS accounting system and created a downsized personal computer accounting system. The personal computer accounting system did not include general ledger accounting functions. In 1992, DoDEA replaced the outmoded personal computer accounting system with a system developed in-house, the FCS.

**Funds Control System.** The FCS was designed as an interim system until DoDEA could develop an integrated accounting system to include the FCS. WHS allowed DoDEA to use the WHS accounting system as temporary host for the personal computer accounting system. Throughout 1993 and 1994, DoDEA had problems interfacing and transmitting transaction line-item data from the FCS to the WHS accounting system. As a result, FCS was a stand-alone system.

**Development of an Integrated Accounting System.** To develop an integrated accounting system, DoDEA purchased a Hewlett Packard 9000 computer system

## **Finding B. General Ledger Accounting System**

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and a software license and hired contractors and additional personnel. Because DoDEA did not track the costs associated with the development of an integrated accounting system as a separate project, we were unable to determine the cost of the Hewlett Packard 9000 computer system from the documents DoDEA provided or from the property record. The software license cost approximately \$0.1 million.

The DoDEA did not succeed in developing an integrated accounting system to interface with FCS because of the low priority it gave the project and because it purchased the wrong software license. After our audit began, DoDEA put on hold its plans to develop its own accounting system and decided to return to WHS for accounting support. However, DoDEA continues to use the FCS as its only accounting system because problems interfacing the FCS with the WHS accounting system have not been resolved.

### **Correcting Previously Identified Accounting System Deficiencies**

The DoDEA also did not have a general ledger accounting system because it did not place a high priority on correcting previously identified accounting system deficiencies. Since 1984, the Inspector General, DoD; the General Accounting Office (GAO); and WHS have identified weaknesses in the DoDEA accounting system.

**Inspector General, DoD, Inspection Report.** Inspector General, DoD, "Inspection of the Department of Defense Dependents Schools," January 8, 1985, reported that DoDEA (formerly DoDDS) did not have an independent accounting system, resulting in inadequate financial management controls. DoDEA concurred with the finding and responded that a totally integrated financial management system would be developed by 1986. In 1988, DoDEA developed an accounting system. However, a 1991 followup Inspection report, Report No. 91-INS-03 continued to report deficiencies. The Inspector General, DoD, reported that the accounting system was inadequate and that it did not comply with DoD and GAO accounting guidelines, such as the use of the U.S. Government Standard General Ledger Chart of Accounts. The accounting system deficiencies remain uncorrected.

**GAO Testimony to House Subcommittee.** In an April 1994 hearing before the Readiness Subcommittee, House Committee on Armed Services, GAO testified that DoDEA did not have an adequate accounting system. Because of weaknesses in the underlying accounting system, GAO could not verify the accuracy for some of the data used in its review.

## **Finding B. General Ledger Accounting System**

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**WHS Offers Assistance.** In 1994, WHS informed DoDEA that general ledger functions must be included in the DoDEA accounting system to meet GAO accounting system guidelines. WHS offered to assist DoDEA in developing a general ledger accounting system. DoDEA did not accept WHS assistance until after our audit began.

### **Summary**

A DoD conforming general ledger accounting system is needed to provide information necessary to produce auditable and accurate financial statements. Because of inadequate planning and low priority on correcting previously identified accounting system deficiencies, DoDEA does not have a general ledger accounting system. Therefore, DoDEA was unable to provide the information necessary to produce auditable and accurate financial statements required by the CFO Act.

### **Recommendation, Management Comments, and Audit Response**

**B. We recommend that the Director, Department of Defense Education Activity, plan and establish, in conjunction with the Under Secretary of Defense (Comptroller), the Defense Finance and Accounting Service, and the Washington Headquarters Services, a general ledger accounting system that uses the DoD Uniform Chart of Accounts.**

**Management Comments.** The DoDEA nonconcurred and stated that its accounting system used the original WHS accounting system design and controls, and, therefore, approval of either DFAS or the Under Secretary of Defense (Comptroller) is not required.

**Audit Response.** The DoDEA comments do not respond to the finding and the recommendation. We did not recommend that DoDEA get approval from the Under Secretary of Defense (Comptroller) and DFAS. However, we do believe that those offices should be involved in the planning and establishment of a general ledger accounting system. This is one of the reasons we added Recommendation A.5. We request that DoDEA reconsider its position and provide additional comments on the final report.

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## **Finding C. Implementation of the DoDEA Management Control Program**

The DoDEA did not adequately implement its management control program and review accounting system controls as required by DoD Directive 5010.38 and the Financial Regulation. Inadequate implementation and review occurred because DoDEA did not:

- o identify and assign a level of risk or vulnerability for the assessable units in the organization and
- o evaluate the accounting system using all applicable key accounting requirements.

As a result, the DoDEA management control program and the FY 1995 annual system review could not be relied upon to verify the adequacy of controls for the assessable units and for the accounting system DoDEA used.

### **Management Control Program**

DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987, requires DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of controls. An effective management control program should:

- o organize the management control process.
- o segment the DoD Component into assessable units.
- o document risk assessments on the assessable units.
- o develop a management control plan based on the level of risk (high, medium, or low) assigned to the assessable units.
- o perform management control reviews as necessary.
- o prepare an annual statement of assurance to include a report on the status of accounting systems' conformance with Comptroller General accounting principles, standards, and related requirements.

DoD Directive 5010.38 and the Financial Regulation provide requirements for the annual review and reporting on accounting systems' conformance. The Financial Regulation establishes 13 key accounting requirements (KARs) that are included in the FY 1995 System Manager/User Review Guide for Operational Systems (DFAS Review Guide) issued by DFAS. The DFAS

## **Finding C. Implementation of the DoDEA Management Control Program**

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Review Guide supplements the Financial Regulation with questions designed to assist system managers and users in determining whether accounting system controls are in place and working for the 13 KARs. Responses to questions related to six KARs are mandatory and must be completed for all DoD accounting systems. The DFAS Review Guide requires the reviewer to determine the applicability of the other seven KARs to the specific accounting system under review. The applicability of a KAR to an accounting system is determined by organizational functions and whether an interfacing system, under the control of another system manager, performs the required accounting functions. The following table lists the 13 KARs in the order provided in the DFAS Review Guide.

### **Key Accounting Requirements for FY 1995**

<u>Requirement</u>	<u>Mandatory</u>
General ledger control and financial reporting	No
Property and inventory accounting	No
Accounting for receivables including advances	No
Cost accounting	No
Accrual accounting	Yes
Military and civilian payroll procedures	No
System controls (fund control and internal controls)	Yes
Audit trails	Yes
Cash procedures and accounts payable	No
System documentation	Yes
System operations	Yes
User information needs	Yes
Budgetary accounting	No

## **Risk Assessments**

The DoDEA did not adequately implement its management control program by identifying and assigning a level of risk or vulnerability for the assessable units in the organization. DoDEA segmented the organization into assessable units. DoDEA asked managers with internal management control responsibilities to comment on the assessable units and identify areas susceptible to fraud, waste and abuse. The responses were gathered; however, DoDEA did not summarize the responses and perform risk assessments by assigning an appropriate level of risk (high, medium, or low) to each assessable unit. By not assigning a level of risk to the assessable units, the DoDEA management control program would not provide for reviews of assessable units with the highest level of risk. Thus, there was no reasonable assurance that material control weaknesses would be identified. Also, the DoDEA management control program could not be relied on to verify the adequacy of controls for the assessable units.

## **Review of Accounting System Controls**

The DoDEA did not review its accounting system controls as required. In its performance of the required annual system reviews, DoDEA did not evaluate the accounting system using all applicable KARs as established in the Financial Regulation and the DFAS Review Guide. As a result, the annual system reviews could not be relied on to verify the adequacy of controls for the DoDEA accounting system. Further, the lack of a general ledger accounting system was not reported as a material weakness in the FY 1995 Annual Statement of Assurance.

**DoDEA FY 1995 Annual Review of Accounting System Controls.** The DoDEA performed a review of accounting system controls in the FCS and included the results in the "DoDEA Report on Accounting System Conformance to Comptroller General Accounting Principles, Standards, and Related Requirements," Tab D of the Annual Statement of Assurance. The FY 1995 annual review incorrectly stated that the FCS was substantially in compliance with GAO accounting principles, standards, and related requirements.

**Adequacy of DoDEA Annual Review.** Documentation supporting the DoDEA FY 1995 review of accounting system controls did not support its conclusion that FCS was substantially in compliance with GAO accounting principles, standards, and related requirements. The DoDEA review did not address:

- o general ledger control and financial reporting,
- o property and inventory accounting,
- o cost accounting,
- o military and civilian payroll procedures, and
- o cash procedures and accounts payable.

The above KARs, although shown as not mandatory in the DFAS Review Guide, should have been performed since the FCS did not interface with a supporting system. As a result, the FY 1995 annual system review could not be relied on to verify the adequacy of controls for the accounting system used by DoDEA. Further, had DoDEA performed the required review, DoDEA would have reported the lack of a general ledger accounting system as a material weakness in its FY 1995 Annual Statement of Assurance.

## **Finding C. Implementation of the DoDEA Management Control Program**

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### **Recommendations, Management Comments, and Audit Response**

**C. We recommend that the Director, Department of Defense Education Activity:**

**1. Perform risk assessments and assign an associated level of risk to all assessable units. Use the risk assessments in the development of a management control program, including a formal review program.**

**Management Comments.** The DoDEA nonconcurred, stating that through its extensive use of alternative reviews, each assessable unit was reviewed every year. Therefore, the DoDEA management control program exceeded regulatory requirements. In addition, the process was effective in identifying material weaknesses for management's consideration.

**Audit Response.** The DoDEA alternative reviews have not been effective or they would have identified the problems noted in Report No. 96-125, on poor management of an Automated Information System, and in Report No. 96-159, on Antideficiency Act violations, the lack of control over property, and accounting, identified in this report and the idle computer assets identified in our ongoing review. The DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987, is being revised in response to a recent revision of Office of Management and Budget Circular A-123 "Management Accountability and Control," June 29, 1995. No matter what revisions are made, DoDEA needs to improve its Management Control Program so that it works. We request that DoDEA provide additional comments on the recommendation.

**2. Use all applicable key accounting requirements when performing FY 1996 and subsequent annual reviews, coordinating the reviews with the Defense Finance and Accounting Service for completeness and adequacy, and reporting material weaknesses, such as the lack of a general ledger accounting system, in its Annual Statement of Assurance.**

**Management Comments.** The DoDEA nonconcurred, stating that in conducting the review of accounting system controls, only those areas of the review guide pertaining to operational systems were examined; reviews of nonoperational systems would be meaningless. It further stated that excluding the general ledger from the review did not presuppose that DoDEA did not recognize it as a material weakness.

**Audit Response.** DoDEA agreed that it did not conduct accounting system reviews for all KARs as established in the Financial Regulation and the DFAS Review Guide. However, without having conducted the reviews, DoDEA incorrectly reported in the FY 1995 Annual Statement of Assurance that the FCS was substantially in compliance with GAO accounting principles, standards, and related requirements. Further, DoDEA did not report the absence of the KARs, such as the lack of a general ledger accounting system as a material weakness in the FY 1995 Annual Statement of Assurance. In



### **Finding C. Implementation of the DoDEA Management Control Program**

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addition, DoDEA did not coordinate the review with DFAS for completeness and accuracy. We request that DoDEA provide additional comments on the recommendation.

## **Part II - Additional Information**

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## Appendix A. Audit Process

### Scope

We reviewed DoD and DoDEA policies and procedures relating to management controls, financial transactions, and asset accountability. We evaluated DoDEA budget submissions, financial reports, and the underlying supporting records from FYs 1994 and 1995. We reviewed property records in DSAMMS and data from reports of survey for FYs 1994 and 1995. We reviewed FCS capabilities and plans to develop an accounting system. We reviewed the Annual Statement of Assurance for FYs 1994 and 1995 and prior reports from FY 1991 through FY 1995 addressing financial controls. We also interviewed personnel at DoDEA, DFAS, WHS, the Office of the Under Secretary of Defense (Comptroller), and the Department of the Navy.

**Use of Computer-Processed Data.** To evaluate the overall financial management controls at DoDEA, we used computer-processed data from DSAMMS and FCS. We also reviewed computer generated financial reports. We did not evaluate general and application controls for the systems, although we relied on data produced by DSAMMS and FCS to assess the financial management control environment. As stated in the report, the DSAMMS and FCS data were not accurate and should not be relied on.

**Audit Period, Standards, and Locations.** We performed this financial-related audit from April 1995 through January 1996 in accordance with auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD. Accordingly, we included such tests of management controls considered necessary. Appendix E lists the organizations we visited or contacted.

### Methodology

We evaluated the organizational structure after a FY 1995 reorganization to determine the effect on the control environment. We reviewed financial reports to determine program code and object class spending. We reviewed financial reports and compared them to the underlying supporting documentation to determine the accuracy of the audit trail.

We reviewed assets in the DSAMMS with a reported value of \$5,000 or greater. We also compared the DSAMMS report to information in the FCS with asset object classes, from FY 1994 through FY 1995. We evaluated information in reports of survey for FYs 1994 and 1995 to determine the accountability over assets. We also tested for completeness and accuracy of the

property records, and performed a limited inventory of assets on hand at DoDEA Headquarters. We did not use statistical sampling procedures for this audit.

We evaluated the FCS and compared our results to standards for conforming financial systems to determine whether the system could provide reliable and auditable financial statements.

To determine the adequacy of the DoDEA management control program, we reviewed the process DoDEA used to develop the Annual Statement of Assurance for FYs 1994 and 1995. We also reviewed the management control program to determine whether risk assessments with an assignment of risk (high, medium, or low) were performed for the assessable units. We reviewed the FY 1994 and 1995 Annual Statement of Assurance for completeness. In addition, we reviewed documentation supporting the annual review of accounting system controls and compared it to DoD guidelines.

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## **Appendix B. Prior Audits and Other Reviews**

### **General Accounting Office**

**GAO 1994 Testimony.** In April 1994, GAO testified before the Subcommittee on Readiness, House Committee on Armed Services, on military dependents' education and potential savings in DoDDS. GAO personnel stated that because of underlying weaknesses in the DoDEA accounting and information systems, they were unable to verify the accuracy of data obtained during their review.

### **Inspector General, DoD**

**Inspector General, DoD, Report No. 96-159.** The Inspector General, DoD, issued Report No. 96-159, "Quick-Reaction Report on Potential Antideficiency Act Violations at the Department of Defense Education Activity," June 13, 1996. The report discussed potential Antideficiency Act violations in FY 1995 Operation and Maintenance funds and FYs 1987 and 1993 Foreign Currency Fluctuation, Construction funds. The report also discussed the internal controls needed to ensure that adequate funds are available to prevent violations of the Act.

The report recommended that DoDEA obtain an opinion from the Office of the General Counsel to determine whether automated information system equipment purchased should be classified as investment or expense items, monitor the military construction payment schedules and disbursements and exchange rates, and investigate the potential violations of the Antideficiency Act. DoDEA did not agree to obtain an opinion from the Office of General Counsel. DoDEA did not agree that Antideficiency Act violations occurred. DoDEA agreed to monitor exchange rate fluctuations and initiated an investigation into potential Antideficiency Act violations for Foreign Currency Fluctuation, Construction funds. At the time of this report additional comments were requested from DoDEA to resolve the issues.

**Inspector General, DoD, Report No. 96-125.** The Inspector General, DoD, issued Report No. 96-125, "Quick-Reaction Report on the Acquisition of the Department of Defense Education Activity Automated Information System," May 21, 1996. The report discusses the DoDEA financial management controls over the acquisition of a Major Automated Information System (MAIS). The report identified that DoDEA did not provide adequate overall management for the acquisition of a MAIS estimated to cost \$418.5 million.

The report recommended that the Under Secretary of Defense (Comptroller) review the amended DoDEA budget submissions for the MAIS; that the Deputy

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Intelligence Acquisition) perform the required MAIS review council milestone reviews; that the Deputy Assistant Secretary of Defense (Personnel Support, Families, and Education) review and approve the mission need statement and confirm that DoDEA implements required policies and procedures for management of a MAIS; that DoDEA discontinue the MAIS acquisitions until the program is restructured and managed in accordance with DoD policies and procedures, prepare and submit required documentation for the MAIS, and amend and submit the FY 1997 budget exhibits for the MAIS. The Under Secretary of Defense (Comptroller) concurred, the Deputy Assistant Secretary of Defense (Command, Control, Communications, and Intelligence Acquisition) nonconcurred, the Deputy Assistant Secretary of Defense (Personnel Support, Families, and Education) concurred, and DoDEA nonconcurred with the first two recommendations but partially concurred with the recommendation to amend the budget exhibits. At the time of this report negotiations are ongoing with DoDEA on how to implement the intent of the recommendations.

**Inspector General, DoD, Report No. 91-INS-03.** The Inspector General, DoD, issued Inspection Report No. 91-INS-03, "Department of Defense Dependents Schools," March 1, 1991. The report discussed the accounting system, the accountability over assets, and the management control program of DoDDS. The report was a followup to a 1984 Inspections report. The report identified continuing problems in the accounting system and a lack of reconciliation of the financial accounts with the property records. In addition, the report stated that the Internal Management Control Program was not fully effective because of inadequate follow-up procedures and ineffective oversight in the high and medium risk vulnerability areas.

The report recommended that DoDDS develop a program budget and establish a general ledger to comply with DoD and GAO accounting guidelines, reconcile fixed assets with accounting records, and review Internal Control Office functions and realign to focus on primary mission. DoDDS concurred with the recommendations. Findings A and B in this report discuss that the problems identified in 1984 and 1991 were not corrected.

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## **Appendix C. Actions Needed for Auditable Financial Statements**

The following lists the actions DoDEA must accomplish to produce financial information needed to prepare reliable and auditable financial statements.

- o It must maintain an accounting system for all organizational units that:
  - o utilizes the DoD Uniform Chart of Accounts for assets, liabilities, equity, expenses, losses, gains, transfers in and out, and financing sources;
  - o utilizes a double entry set of accounts to reflect budget authority, undelivered orders, obligations, expenditures, and other necessary accounts;
  - o utilizes accrual accounting;
  - o utilizes a fully integrated transaction-based general ledger system;
  - o includes adequate internal controls to prevent, detect, and correct errors and irregularities; and
  - o ensures obligations and expenditures do not exceed the amount appropriated, apportioned, reapportioned, allocated, and allotted.
- o It must document the system including interfaces between accounting system segments.
- o It must maintain financial policies and procedures.
- o It must make sure audit trails exist that allow transactions to be traced from initiation through processing to final reports.
- o It must reconcile subsidiary accounts with the control accounts monthly.
- o It must reconcile property records to the accounting records.
- o It must maintain and evaluate financial internal control systems.
- o It must establish procedures for preparing financial statements.

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## **Appendix D. Organizations Visited or Contacted**

### **Office of the Secretary of Defense**

Office of the Under Secretary of Defense (Comptroller), Washington, DC

### **Department of the Navy**

Office of the Navy Comptroller, Chief of Naval Education and Training,  
Pensacola, FL

### **Other Defense Organizations**

DoD Education Activity, Arlington, VA  
Defense Finance and Accounting Service, Cleveland, OH  
Defense Finance and Accounting Service, Indianapolis, IN  
Defense Finance and Accounting Service, Pensacola, FL  
Washington Headquarters Services, Washington, DC



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## **Appendix E. Report Distribution**

### **Office of the Secretary of Defense**

Under Secretary of Defense (Comptroller)

Director for Accounting Policy

Deputy Chief Financial Officer

Deputy Comptroller (Program/Budget)

Assistant Secretary of Defense (Force Management Policy)

Deputy Assistant Secretary of Defense (Personnel Support, Families, and Education)

Assistant to the Secretary of Defense (Public Affairs)

Director, Defense Logistics Studies Information Exchange

### **Department of the Army**

Auditor General, Department of the Army

### **Department of the Navy**

Assistant Secretary of the Navy (Financial Management and Comptroller)

Auditor General, Department of the Navy

### **Department of the Air Force**

Assistant Secretary of the Air Force (Financial Management and Comptroller)

Auditor General, Department of the Air Force

### **Other Defense Organizations**

Director, Defense Contract Audit Agency

Director, Defense Finance and Accounting Service

Director, Defense Logistics Agency

Director, Department of Defense Education Activity

Director, National Security Agency

Inspector General, National Security Agency

Inspector General, Defense Intelligence Agency

Director, Washington Headquarters Services

## **Non-Defense Federal Organizations and Individuals**

Office of Management and Budget

Inspector General, U.S. Department of Education

General Accounting Office

    National Security and International Affairs Division

    Technical Information Center

Chairman and ranking minority member of each of the following congressional committees and subcommittees

    Senate Committee on Appropriations

    Senate Subcommittee on Defense, Committee on Appropriations

    Senate Committee on Armed Services

    Senate Committee on Governmental Affairs

    House Committee on Appropriations

    House Subcommittee on National Security, Committee on Appropriations

    House Committee on Government Reform and Oversight

    House Subcommittee on National Security, International Affairs, and Criminal  
    Justice, Committee on Government Reform and Oversight

    House Committee on National Security

## **Part III - Management Comments**

# Department of Defense Education Activity Comments



DEPARTMENT OF DEFENSE  
EDUCATION ACTIVITY  
4040 NORTH FAIRFAX DRIVE  
ARLINGTON, VIRGINIA 22203-1635  
MAY 23 1996



MEMORANDUM FOR DIRECTOR, LOGISTICS SUPPORT DIRECTORATE,  
OFFICE OF THE ASSISTANT INSPECTOR GENERAL FOR  
AUDITING, DOD

SUBJECT: Comments on Draft Report on Management Control Environment for the  
Department of Defense Education Activity (DoDEA), Dated March 18,  
1996, (Project No. 5LA-2027)

The following are the comments of the Department of Defense Education Activity  
(DoDEA) to the findings and recommendations addressed in the subject draft report:

## FINDING A DoDEA MANAGEMENT CONTROL ENVIRONMENT

**FINDING (Page 4):** *DoDEA management control environment needed improvement. Improvements were needed because DoDEA closed the independent internal review office without plans for replacement.*

**DODEA RESPONSE:** Nonconcur

Beginning in fiscal year 1994-95, the DoDEA cabinet conducted an extensive review of each division and function within the headquarters' operation to enhance the efficiency and effectiveness of the organization. The review focused on eliminating all functions no longer relevant; staffing new functions; eliminating redundant, duplicative functions; and locating offices for efficient communication.

The Internal Management Control (IMC) program received a great deal of scrutiny and careful analysis. The cabinet decided that the IMC function should be relocated to the DoDEA headquarters and operate as a centralized function. It was also determined that the emphasis of the IMC program should be (1) operating according to the DoDEA determination and statement of organizational objectives and (2) providing the means for testing the accomplishment of these objectives.

Moreover, it was determined that the DoDDS Internal Review Office (IRO) could not fulfill its intended audit, inspection, and investigative missions without the infusion of personnel and monetary resources. Because the IRO duplicated functions available from sources external to DoDEA, a decision was made to eliminate the IRO and use external audit, inspection, and investigative organizations within a regular management cycle of

review or whenever a requirement was identified. In eliminating specific aspects of the operations of the IRO, the DoDEA leadership did plan for obtaining those services from other sources.

The DoDEA, under the leadership of the Associate Director for Accountability developed new DoDEA policies and procedures for meeting the intent of the Federal Managers' Financial Integrity Act of 1982 (Integrity Act). The new DoDEA policies and procedures were based upon the June 29, 1995, final revision of Office of Management and Budget (OMB) Circular No. A-123 "Management Accountability and Control." This new circular replaces the previously titled "Internal Control Systems" and serves to implement the Integrity Act. The revised OMB circular clearly promotes a framework for agency management control programs that integrates management control activities with other management requirements and policies, such as the Inspector General Act. The foundation of this policy is that "Management control activities are not stand alone management practices, but rather are woven into the day-to-day operational responsibility of agency managers." The language in the circular clearly defines internal controls as a subset of management controls. OMB in its authority included management standards in the circular and modified the language of the General Accounting Office's (GAO) 1983 "Standards for Internal Control."

It was in the spirit and intent of the revised OMB circular that DoDEA reviewed and revised its IMC program. DoDEA's implementation of the IMC program clearly stresses continuous monitoring and periodic detailed evaluations. New policies and procedures were developed with critical attention paid to the internal review functions previously performed by the IRO. (Attachments 1 and 2). These functions are viewed as an integral part of the IMC program and clearly outlined in DoDEA policies and processes. The plan included:

- Recognition of internal review as an integral part of the IMC function.
- Obtaining audit services from cognizant DoD audit activities or other external sources when vulnerable areas are identified.
- Established cycles of continuous monitoring as outlined in the DoDEA Strategic Plan.

The OMB circular specifically encourages meeting the circular's planning requirements by addressing management controls in a broader strategic plan for agency management. The purpose of the circular is to provide flexibility and benefit rather than inhibit or encumber management and "should make sense for each agency's operating structure and environment." This is accomplished by allowing agencies discretion in selecting appropriate tools to use in developing the Integrity Act Annual Assurance Statement for the President and the Congress.

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The guidance does not require a separate internal review function. In fact, the circular encourages the integration of the internal review function within the IMC program. The OMB Director, Ms. Alice M. Rivlin, provides this guidance on the circular. "Instead of considering controls as an isolated management tool, agencies should integrate their efforts to meet the requirements of the Integrity Act with other efforts to improve effectiveness and accountability. Thus, management controls should be an integral part of the entire cycle of planning, budgeting, management, accounting, monitoring and auditing. They should support the effectiveness and integrity of every step of the process and provide continued feedback to management." The OMB guidance also states that "a subset of management controls are the internal controls used to assure that there is presentation or timely detection of unauthorized acquisition, use, or disposition of the entity's assets."

The principles outlined in the OMB guidance represent the foundation upon which the DoDEA IMC program is built. We strongly believe it is a firm foundation. We have just begun to implement our new policies and are well on our way to a much stronger, comprehensive and integrated IMC program. Ms. Rivlin also cautions: "Federal managers must carefully consider the appropriate balance of controls in their programs and operations. Fulfilling requirements to eliminate regulations ("Elimination of One-Half of Executive Branch Internal Regulations," Executive Order 12861) should reinforce to agency managers that too many controls can result in inefficient and ineffective government, and therefore that they must ensure an appropriate balance between too many controls and too few controls. Managers should benefit from controls, not be encumbered by them."

In restructuring the DoDEA IMC function as a centrally managed headquarters level office, DoDEA has taken affirmative steps in implementing the OMB guidance and in assuring a comprehensive and responsive management control environment.

**FINDING (Page 5):** *The DoDEA closed its independent internal review office without plans for replacement.*

**DODEA RESPONSE:** Nonconcur.

The paragraph as written is misleading. The DoDEA internal control officer served as the supervisory auditor for the Internal Review Office (IRO). The internal review function was always a subset of the DoDDS and subsequently DoDEA Internal Management Control (IMC) program. The decision to close the IRO was predicated upon a comprehensive review of the mission and requirements of the IRO. That review disclosed that the IRO could not effectively fulfill its mission without increasing the personnel staffing and funding for the office. Because audit, inspection, and investigative services were available from the cognizant DoD audit organization, the Military Services, and by contract from external sources it was determined that the best alternative was to close the IRO and relocate the internal control function to the DoDEA headquarters.

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**FINDING (Page 6):** *The DoDEA did not have adequate controls over budget formulation and execution.*

**DODEA RESPONSE:** *Nonconcur.*

The Director of the OMB and the DoD Comptroller issue definitive guidance and controls for both the formulation and execution of the budget. Formulation of the DoDEA budget conforms to established policies and procedures using Comptroller required exhibits within published inflation rates and fiscal controls. The DoDEA budget is reviewed twice annually by the OMB and the DoD Comptroller. The final product is reviewed by congressional staff. Program fiscal controls are revised for changing inflation, programmatic changes such as fluctuating enrollments and expansion of the preschool program, and congressional inserts and deletions.

The audit trails for the execution of the budget are supported by funding documents, funding formula, and internal documentation in the form of memoranda. The funding documents cite 31 U.S.C. 1517, the "Antideficiency Act," one of the primary "enforcement devices." The suballocation of funds passes to each manager the responsibility of executing funds in accordance with Federal statute and congressional guidance. The integrity of the budget is maintained from the inception at formulation through execution by the local field activity.

**FINDING (Page 6):** *The DoDEA management eliminated the requirement for managers from subordinate organizations to submit budgets for use in the budget formulation process.*

**DODEA RESPONSE:** *Nonconcur.*

There is no DoD regulation which requires formulation of the budget based on budget submissions from subordinate activities. DoDEA conforms to common practice in U.S. public school districts of formulating budgets at the central office and distributing funding by formula. In addition, Public Law 95-561 directs the Director to prepare a "unified budget for each fiscal year . . . for the dependents education system." Public Law 95-561 also requires the Director to "establish a formula for determining the minimum allotment of funds for the operation of each school".

**FINDING (Page 7):** *The DoDEA eliminated budget execution controls over program codes.*

**DODEA RESPONSE:** *Nonconcur.*

The memorandum to which the report refers applied only for the remainder of FY 1995. The guidance was intended to reduce the work load required in shifting budget

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targets at year-end. Strict controls were in place prior to the August time frame and have been reinstituted in FY 1996.

**FINDING (Page 7):** *The DoDEA disregarded budget execution controls, such as plans showing monthly spending by object class, for equipment purchases.*

**DODEA RESPONSE:** Nonconcur.

There is no DoD requirement to prepare a monthly spending plan by object class. In addition, DoDEA fixed costs are approximately 90 percent of the budget. Many costs are not known until late in the fiscal year (for instance, the pay raise is not determined until May and paid in late June). DoDEA must ensure that all bills can be paid before it can embark on equipment purchases.

**FINDING (Page 8):** *The DoDEA did not have adequate controls over accounting transactions and financial reporting because of the following:*

*1. Collecting and Consolidating Accounting Transactions. The DoDEA did not have a financial system that collected and consolidated accounting transactions for all organizational units.*

**DODEA RESPONSE:** Concur.

DoDEA does not have an automated system which consolidates accounting transactions for all organizational units. The Defense Finance and Accounting Service Center - Indianapolis has begun an initiative that will consolidate all accounting transactions into a central data base for all Treasury Index 97 allotment holders. The single data base at Indianapolis will edit all data, accomplish checks and balances, prepare departmental reports/data files for Defense Agencies and OSD, as appropriate. This will be accomplished by October 1, 1996.

*2. Accounting Policies and Procedures. DoDEA did not have adequate accounting policies and procedures because:*

*(1). DoDEA Accounting Manual (Page 9). The DoDEA accounting manual applied to DoDDS and not DDESS.*

**DODEA RESPONSE:** Nonconcur.

The DoD Domestic Dependent Elementary and Secondary Schools (DDESS) accounting support is provided by the Department of Defense Finance and Accounting Service (DFAS) (Pensacola). The Department's accounting policies and procedures are established by DFAS. Therefore, in that DDESS is already supported by a DFAS entity

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adhering to the DoD Financial Management regulation 7000.14R, they should not be included in the DoDDS accounting manual that supports a non-DFAS system.

*(2). Policies and Procedures for Recording Accruals. (Page 9) The DoDEA had not developed adequate policies and procedures to record accruals for accounts payable upon the receipt of goods and services as required by the Financial Regulation.*

**DODEA RESPONSE:** Partially concur.

The DoDDS manual specifically states that accruals must be recorded in the allotment accounting system upon receipt of goods or services. This statement meets the criteria established in OMB Circular A-34 and the DoD Financial Management Regulation. However, in practice, this cannot always be accomplished. Therefore, the DoDDS accounting regulation states that in order to minimize workload, accruals may be recorded simultaneously with either an obligation or a disbursement. To avoid any confusion in the future about this, we are preparing a procedural memorandum for our fiscal stations establishing a reasonable threshold for the recording of new accruals.

*(3). Accounting Guidance for Disbursements (Page 10). DoDEA headquarters issued accounting guidance for recording disbursements for special projects that did not comply with the Financial Regulation.*

**DODEA RESPONSE:** Nonconcur.

The auditors discovered one paragraph of a desk procedure pertaining to the non-posting of a disbursement against a special project which would result in a negative balance. The intent of this section was not to stop the posting of a disbursement but rather to have the accounting technician request a review by a professional accountant prior to processing. This was needed to reduce erroneous postings, not to circumvent the law. In order to avoid any further confusion, we have rescinded the subject paragraph from the desk procedures.

**FINDING: (Page 10)** *The DoDEA had not developed adequate procedures for the review of financial reports to ensure accuracy and completeness and to identify material irregularities. As a result, there was no assurance that accounting transactions were recorded properly and financial reports were complete and accurate, specifically:*

*(1). Foreign Currency Fluctuation Reports (Page 10). Reviews of foreign currency fluctuation reports did not ensure that the reports were complete for MILCON funds.*

**DODEA RESPONSE:** Nonconcur.

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The elements of the foreign currency report for MILCON (DD-1761) which were identified as blank fields, have always been reported that way. Until DFAS-IN started consolidating our data this fiscal year, our monthly reports were not questioned. Although that fact by itself is not a justification for providing an incomplete report, there is no effective way of predicting foreign currency values for tomorrow or 1 year from now. Since all obligations are based on disbursements, there can never be unliquidated obligations. If that field must be reported, it would always contain a zero amount. We can make estimates of our 6-month disbursements for fluctuation, but there is no realistic way of determining this figure.

*(2). Report on Unmatched Disbursements (Page 10). The Chief of the DoDEA Fiscal Division did not adequately review the September 1995 Report on Unmatched Disbursements, to ensure that the report was accurate and complete.*

**DODEA RESPONSE:** Concur.

The unmatched reporting requirement had recently been established by DFAS at the request of the DoD Comptroller and several format changes had taken place during the initiation phase. Our office in Europe, having the largest volume of transactions, had some difficulty in providing the required breakout of data. Although we did not inform DFAS of the omission, we did accurately report this data in October of 1995, and in all subsequent reports.

*(3). The DD-1176 Report. (Page 11) DoDEA did not perform adequate reviews of the DD-1176 Report, therefore, did not recognize that it was inaccurate.*

**DODEA COMMENTS:** Partially-concur.

(a). The monthly DD-1176 data which we receive from the DFAS centers are never received in time for our current report month. Therefore, we are forced to use the previous month's data. This problem has been addressed with DFAS-HQ and there has been no resolution. At year-end we are given additional time to submit our reports and, therefore, will have DFAS' September data contained in our DD-1176. Because of this anomaly, August data are skipped every year. We have no control over this situation.

(b). The change in obligation status referred to in the draft report occurred because we changed our policy on the use of the Cash Book. We were aware of the change in obligation status and did not believe it was necessary to inform WHS of this status, since this information was already contained on the report. We are responsible for the data on these reports which are subject to review by higher authority. The report was not inaccurate nor was there a material irregularity as described in the draft report. However, in order to avoid confusion in the future, we will footnote the report if similar circumstances occur.

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**FINDING (Page 11):** *The DoDEA did not have adequate controls:*

**DODEA RESPONSE:** Partially concur.

Version 1.2D of DSAMMS was fielded in FY 1990. Its sole purpose was to automate the requisition preparation function, keep an informal "checkbook" in a chart of accounts and provide the user with a method of annotating the basic requisitioning transactions with status as the acquisition moved through the procurement process from generation of the requirement to the processing of the material receipt.

The property accounting module of DSAMMS was fielded in FY 1995. Prior to that time, schools used "home grown," semi-automated systems for tracking accountable property. All methods employed to account for materiel assets have been in compliance with the policies and procedures established in DSM 4100.2, "DoDDS Material Management Manual." Standard, uniform DoDDS property accounting procedures were first promulgated in this manual prior to the current revision which was published in July 1986.

**FINDING (Page 12):** *The Dependent Schools Automated Material Management System (DSAMMS) Users Manual needed improvement by including procedures to ensure that information included in the DSAMMS property records were accurate, promptly recorded, consistent, and complete.*

**DODEA RESPONSE:** Nonconcur.

The DS 4100.3-G, "DSAMMS Users' Reference Guide," does not contain policies and procedures for any aspect of material management in DoDEA. It is a "how to" manual, designed to provide the user with instructions on how to operate various mechanical transactions in the automated system. Policies and procedures for material management are contained in DSM 4100.2 (See above reference in paragraph 1). The difference between these two manuals was repeatedly pointed out to various members of the DoDIG team. The cost of individual assets can be derived in two ways: computing the average cost of the assets procured based on the total line item cost from the contract document, or alternatively, from a similar computation based on the cost reflected in the DSAMMS requisitioning record for the item. It is apparent from the finding language that the auditors did not fully understand the purpose of the DS 4100.3-G. Accountable officers are currently refining and standardizing the noun/nomenclature descriptions for accountable property in their standard property catalogs-one of which is maintained for each formal property record. It would serve no useful purpose to try to include this catalog in the DS 4100.3-G. After the individual catalogs have been scrubbed, DoDEA plans to publish a single, standard catalog for use by property custodians to assist them in providing the correct nomenclatures for property assets. Our procedures do require

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property information to be recorded promptly and to include all data elements called for in the record.

**FINDING (Page 12):** *The reasons for asset losses were not explained.*  
**DODEA COMMENTS:** Nonconcur.

The audit team has been provided with copies of the reports of survey (DD 200 actions) for the European area. These list specific reasons for property losses that were identified as "other" on a summary report. Annual inventories are required by regulation and verify assets on hand as well as recording how assets move in and out of the account. When the term "other" is used to identify the cause of an asset loss, it is because the loss was discovered during the inventory process and there is no record as to the item's actual disposition. The \$4.3 million in reported losses in DoDDS Europe were identified at the time of year-end school closures. They reflect an intensive effort on the part of the property management staff in Europe to correct property inventories.

**FINDING (Page 12):** *The DoDEA did not reconcile the DSAMMS property records to the financial system.*  
**DODEA RESPONSE:** Concur.

This effort will be undertaken as a joint Logistics/Fiscal requirement.

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**FINDING (Page 13):** *The DoDEA has not assumed asset responsibility for DDESS, a major unit in the DoDEA organization.*  
**DODEA RESPONSE:** Concur.

Initial planning has started to utilize the DSAMMS property module within DDESS.

RECOMMENDATIONS

**1. RECOMMENDATION:** *DoDEA establish an independent internal review function, properly aligned in the organization, that is staffed, trained, and utilized to provide coverage for the entire organization.*  
**DODEA RESPONSE:** Nonconcur.

The decision to close the internal review office (IRO) was predicated upon a comprehensive review of the mission and requirements of the IRO. That review disclosed that the IRO could not effectively fulfill its mission without increasing the

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personnel staffing and funding for the office. Because audit, inspection, and investigative services were available from the cognizant DoD audit organization, the Military Services, and by contract from external sources, it was determined that the best alternative was to close the IRO and relocate the internal control function to the DoDEA headquarters.

**2. RECOMMENDATION:** *Develop and implement guidance to control budget formulation and execution.*

**DODEA RESPONSE:** Nonconcur.

The Director of the Office of Management and Budget and the DoD Comptroller issue definitive guidance and controls for both the formulation and execution of the budget. Formulation of the DoDEA budget conforms to established policies and procedures using Comptroller required exhibits within published inflation rates and fiscal controls. The DoDEA budget is reviewed twice annually by the Office of Management and Budget and the Comptroller. The final product is reviewed by congressional staff. Program fiscal controls are revised for changing inflation, programmatic changes such as fluctuating enrollments and expansion of the preschool program, and congressional inserts and deletions.

The audit trails for the execution of the budget are supported by funding documents, funding formula, and internal documentation in the form of memoranda. The funding documents cite 31 U.S.C. 1517, the "Antideficiency Act," one of the primary "enforcement devices." The suballocation of funds passes to each manager the responsibility of executing funds in accordance with Federal statute and congressional guidance. The integrity of the budget is maintained from the inception at formulation through execution by the local field activity.

**2a. RECOMMENDATION:** *Require budget submissions from subordinate organizations and use them in budget formulation.*

**DODEA RESPONSE:** Nonconcur.

There is no Department of Defense (DoD) regulation which requires formulation of the budget based on budget submissions from subordinate activities. DoDEA conforms to common practice in U.S. public school districts of formulating budgets at the central office and distributing funding by formula. In addition, PL 95-561 directs the Director to prepare a "unified budget for each fiscal year . . . for the dependents education system." Public Law 95-561 also requires the Director to "establish a formula for determining the minimum allotment of funds for the operation of each school."

**2b. RECOMMENDATION:** *Establish and maintain budget execution controls for spending within program codes and in compliance with bona fide need rule.*

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**DODEA RESPONSE:** Nonconcur.

The memorandum to which the report refers applied only for the remainder of FY 1995. It was intended to reduce the work-load required in shifting budget targets at year end. Strict controls were in place prior to the August time frame and they have been reinstituted in FY 1996.

**3. RECOMMENDATION:** *Establish and maintain controls over accounting transactions and financial reporting.*

*a. Develop a financial system that collects and consolidates all accounting transactions for DoDEA-HQ, DDESS, and the DoDDS Europe and Pacific Service Centers.*

**DODEA RESPONSE:** Concur.

The Defense Finance and Accounting Service has already begun an initiative that will consolidate accounting transactions into a direct reporting of execution/trial balance data from the allotment holders to the TI 97 data warehouse. The single data base at Indianapolis will edit all data, accomplish checks and balances, prepare reports/data files for Defense Agencies and OSD, as appropriate. This will be accomplished by October 1, 1996.

**3b. RECOMMENDATION:** *Revise its accounting manual to conform with DoD Financial Management Regulation 7000.14R. The manual should include policies and procedures on accounting transactions processed through DDESS and on recording accruals upon receipt of goods and services. The manual should also revise accounting guidance for recording special project disbursements to conform with the DoD Financial Management Regulation.*

**DODEA RESPONSE:** Nonconcur.

The DoD DDESS accounting support is provided by the DFAS (Pensacola). The Department's accounting policies and procedures are established by DFAS. Therefore, in that the domestic schools are already supported by a DFAS entity adhering to the DoD Financial Management Regulation 7000.14R, they should not be included in the DoDDS accounting manual that supports a non-DFAS system.

**3c. RECOMMENDATION:** *Establish procedures for the review of financial reports to ensure their accuracy and completeness and to identify material irregularities.*

**DODEA COMMENTS:** Concur.

DoDEA corrected this deficiency in October 1995.

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**4. RECOMMENDATION:** *Establish control over assets:*

*a. Develop policies and procedures to ensure that information in the DSAMMS is accurate, promptly recorded, consistent and complete.*

**DODEA COMMENTS:** Partially concur.

The policies and procedures are in place requiring accurate, promptly recorded, consistent, and complete entries in the property record (DSM 4100.2, Chapter IV) based on regulatory and DoDEA requirements. The cataloging process will correct most inconsistent or erroneous entries. DoDEA will ensure completion of all required data fields as part of this process. However, completion of all these fields should not be mandatory since many fields have been included as an user option rather than information that is required by DoD asset accountability regulations or directives.

**4b. RECOMMENDATION:** *Identify and independently verify the reasons for asset losses include in the reports of survey.*

**DODEA COMMENTS:** Partially concur.

The policies and procedures are in place for conducting DD Form 200, "Financial Liability Investigation of Property Loss" actions. When the preliminary research indicates that further investigation is required, the procedures call for a Financial Liability Officer to be appointed. (DSM 4100.2, Chapter VIII). Copies of requested DD Form 200 actions have been provided to the audit team.

**4c. RECOMMENDATION:** Develop an implementation plan with milestones and interim manual procedures to reconcile the DSAMMS to the financial system.

**DODEA COMMENTS:** Concur.

This will be undertaken as a joint Logistics/Fiscal responsibility.

**4d. RECOMMENDATION:** *Develop policies and procedures to include maintaining the property records and preparing the reports of survey for the DDESS.*

**DODEA COMMENTS:** Concur. Initial planning has been started to field the DSAMMS Property Accountability module within DDESS.

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**FINDING B**  
**GENERAL LEDGER ACCOUNTING SYSTEM**

**FINDING (Page 15):** *As part of the planning process, DoDEA did not coordinate accounting system development efforts with DFAS and the Under Secretary of Defense (Comptroller).*

**DODEA RESPONSE:** Nonconcur.

DoDEA has never advocated or initiated any actions to develop an independent accounting system. At the outset of assuming its own accounting responsibility in lieu of the Military Services, DoDDS adopted the existing accounting system in use by WHS with the approval of the DoD Comptroller. All further developments have been to either maintain system operability (updating obsolete equipment) or to provide data in a format more appropriate for DoDEA management information (revisions to coding structure, or using a database language more commonly used in DoDEA). At no time did any of the original WHS accounting system design or controls change. Therefore, approval of either DFAS or DoD Comptroller is not required.

**FINDING C**  
**IMPLEMENTATION OF**  
**DODEA MANAGEMENT CONTROL PROGRAM**

**FINDING (Page 21):** *The DoDEA did not adequately implement its management control program and review accounting system controls.*

**DODEA RESPONSE:** Nonconcur.

The purpose of assigning a level of risk or vulnerability for the assessable units was to establish priorities in the performance of internal reviews of the assessable units. Within the DoD, a 5-year cycle was used wherein high risk areas were to be reviewed in the first year and all assessable units within the 5-year period. The DoDEA IMC program, through its extensive use of alternative reviews, reviewed each assessable unit every year. By ensuring that each assessable unit was reviewed every year the DoDEA IMC program exceeded the regulatory requirement.

Moreover, the process was effective in identifying material weaknesses for management's consideration. The Office of the Secretary of Defense Annual Statement of Assurance contained the comment that the DoDEA IMC program was effective in reporting material weaknesses at the DoDEA level. The DoDEA IMC program continues to monitor, review, and track all reviews made of DoDEA by their DoDEA assessable

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unit. The most significant change in the process is that senior DoDEA managers are now provided monthly briefings on the type, location, and outcome of all reviews performed of DoDEA functions and activities.

In conducting the review of accounting system controls, only those areas of the review guide pertaining to operational systems were examined. Those areas which were not operational were not scheduled for review during the on site examinations because there was no material to examine. As an example, the requirement to review the general ledger maintenance was not performed because there was no general ledger in existence; any examination of this area would be meaningless. The fact that it was excluded from this review does not presuppose that DoDEA does not recognize this as a material weakness. (See above for status on implementation of the general ledger system.) Similarly, the other areas that were not addressed in the review, recognized the lack of material on which to conduct the review.

We appreciate the opportunity to provide responses. Please do not hesitate to contact Mr. D Sibley at (703)-696-3850, extension 101, if you need additional information or have any questions.

  
for Lillian Gonzalez  
Director

cc:  
DASD (PSF&E)

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## **Audit Team Members**

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